

Internal Revenue Service

District Director

[REDACTED]

Department of the Treasury

P.O. Box 2508
Cincinnati, OH 45201

Person to Contact:

Telephone Number
[REDACTED]

Refer Reply to : EP/EO

Date: NOV 02 1994

Dear Sir or Madam:

We have considered your application for recognition of exemption from Federal income tax under the provisions of section 501(c)(3) of the Internal Revenue Code of 1986 and its applicable Income Tax Regulations.

Based on the information provided by your organization, we have concluded that your organization does not qualify for exemption under section 501(c)(3) of the Internal Revenue Code for the reasons shown on Enclosure I.

Consideration was given to whether you qualify for exemption under other subsections of section 501(c) of the Code and we have concluded that you do not.

As your organization has not established exemption from Federal income tax, it will be necessary for you to file an annual income tax return on Form 1120. Contributions to you are not deductible under section 170 of the Code.

If you are in agreement with our proposed denial, please sign and return one copy of the enclosed Form 6018, Consent to Proposed Adverse Action.

You have the right to protest this proposed determination if you believe that it is incorrect. To protest, you should submit a written appeal giving the facts, law and other information to support your position as explained in the enclosed Publication 892, "Exempt Organizations Appeal Procedures for Unagreed Issues". The appeal must be submitted within 30 days from the date of this letter and must be signed by one of your principal officers. You may request a hearing with a member of the Office of the Regional Director of Appeals when you file your appeal. If a hearing is requested, you will be contacted to arrange a date for it. The hearing may be held at the Regional Office, or, if you request, at any mutually convenient District Office. If you are to be represented by someone who is not one of your principal officers, he or she must file a proper power of attorney and otherwise qualify under our Conference and Practice Requirements as set forth in Section 601.502 of the Statement of Procedural Rules. See Treasury Department Circular No. 230.

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If you do not protest this proposed determination in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust available administrative remedies. Section 7428(b)(2) of the Internal Revenue code provides in part that:

A declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the Claims Court, or the district court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service.

If we do not hear from you within the time specified, this will become our final determination.

Sincerely yours,

[REDACTED]
District Director

Enclosures: 3

cc: [REDACTED]

ENCLOSURE I

[REDACTED]

The application submitted indicates that your organization was incorporated on [REDACTED] in the state of [REDACTED]. You are organized and operated for the purpose of educating youth in necessary job training skills to develop self esteem, responsibility and self awareness. This is accomplished by teaching individual youth financial responsibility, sales skills, time management, and reporting functions.

Your main activity is the sales activity which is [REDACTED]% of your total time for all activities. [REDACTED] percent ([REDACTED]%) of your time is spent on education of the youth which includes their training and a daily 15 minute meeting prior to the daily sales activity. The remaining [REDACTED]% of time is expended on recreational activities which include camping, trips to ball games and theme parks which the organization offers to all of its youth participants. No sales quotas are required for participation in these activities.

The sole source of income for your organization is sales from candy which is sold door to door. The total income for the year ended [REDACTED] was \$[REDACTED] and \$[REDACTED] was the total income for the year ended [REDACTED]. You indicated that financial information for [REDACTED] was not available. The funds raised will be expended specifically for purchase of product; payment of subcontractors; payment of youth salespersons; and overhead expenses which includes recreational activities for youth participants.

You do not have any direct employees. You use sub-contractors (also called crew chiefs) who receive a percentage of sales. The breakdown of the sales revenue indicates that [REDACTED]% is for the cost of the product and is paid directly to the candy manufacturer. The remaining [REDACTED]% is allocated with [REDACTED]% paid to the sub-contractors, [REDACTED]% paid to the youth and [REDACTED]% used for the funding of overhead.

It is the responsibility of the individual crew chiefs to pay the youth who work under them. Youth are provided with uniforms. The average length of stay in the program by the youth is 3 to 6 months.

Subcontractors recruit, train, supervise and transport youth to sales and recreational activities. There are neither resumes nor specific job descriptions available because you stated you do not have them. All contracts between you and the sub-contractors are verbal. [REDACTED] is your founder, president and treasurer. Financial information provided indicates that he will receive compensation of \$[REDACTED] as president/treasurer. [REDACTED] is also shown as a subcontractor.

ENCLOSURE I continued
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[REDACTED]

Revenue for the three months of operation in [REDACTED] was \$[REDACTED] with \$[REDACTED] paid for subcontractors. [REDACTED] as a subcontractor received \$[REDACTED]. Revenue for [REDACTED] was \$[REDACTED] with \$[REDACTED] paid to subcontractors. [REDACTED] received \$[REDACTED] as a subcontractor. No other income was paid to [REDACTED] as an officer of the organization as reflected in the financial data provided.

Financial data indicates that supplier loans (advances) are made to subcontractors for "any individual purpose or request" with [REDACTED] acting as the agent for the candy supplier. No interest is charged on these loans. A supplier bond fund is maintained as collateral for consigned inventory which is maintained by [REDACTED]. There is no relationship between [REDACTED] and the candy supplier, [REDACTED].

The original board had two members, [REDACTED] and his spouse, [REDACTED]. At our request, three additional board members have been added. One of these board members is also a subcontractor.

Section 501(c)(3) of the Code provides, in part, for the exemption from Federal income tax:

Organizations organized and operated exclusively for charitable, religious or educational purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(a)(1) of the Regulations states:

In order to qualify under section 501(c)(3) of the Code, an organization must be both organized and operated exclusively for one or more exempt purposes. If an organization fails to meet either the organizational or operational test, it is not exempt.

Section 1.501(c)(3)-1(a)(2) of the Regulations states:

The term "exempt purpose or purposes", means any purpose or purposes specified in section 501(c)(3) of the Code.

Section 1.501(c)(3)-1(c)(1) of the Regulations states that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3) of the Code. An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

[REDACTED]

Section 1.501(c)(3)-1(d)(1)(ii) of the Regulations states that an organization is not operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. It must not be operated for the benefit of designated individuals or the persons who created it.

In Better Business Bureau of Washington, D.C., Inc. v. United States, 326 U.S. 279, the Supreme Court held that the presence of a single non-exempt purpose, if substantial in nature, will destroy a claim for exemption regardless of the number or importance of truly exempt purposes.

Revenue Ruling 73-127 held that a nonprofit organization that operates a retail grocery outlet and allocates a small portion of its earnings to provide on-the-job training to hard-core unemployed does not qualify for exemption from income tax. Four percent of that organization's earnings is allocated for training. This ruling found that primarily on-the-job training required the existence of an operating business, but that the business was conducted on a scale larger than reasonably necessary for the performance of the organization's training program and was not intended to, nor does it in fact, serve solely as a vehicle for carrying out the training program of the organization. The ruling concluded that the operation of the store and the operation of the training program are two distinct purposes, that is, ends or objects sought to be accomplished by the organization through use of its resources. Since the operation of the store is not recognized as a charitable purpose, the organization is not organized and operated exclusively for a purposes as defined in section 501(c)(3) of the Internal Revenue Code.

You are not operated exclusively for charitable, religious or educational purposes because you are operating a business with benefits inuring to your founder, crew chiefs and youth participants. The recreational activities you provide are part of the compensation promised to your youth participants. You have failed to distinguish between your educational activities and your training activities by crew chiefs. Your educational activities are not, therefore, in furtherance of an exempt purpose.

Based on the facts and the applicable law and precedent, you do not qualify for exemption under section 501(c)(3) of the Internal Revenue Code because you are not operated exclusively for one or more exempt purposes. Your main activity is conducting a business, the sale of a product and is more than insubstantial. Private benefit inures to the founder and the crew chiefs.